



MENU PRICING:

Using consumer data to understand how price increases will impact your business

KEEPING FOODSERVICE EXECUTIVES CURRENT ON INDUSTRY DEVELOPMENTS



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In a recent white paper, we outlined the factors driving the growth of emerging chains. These restaurants demonstrate superior ability to innovate, differentiate, evolve and adapt. To continue in that vein, this white paper focuses on ways restaurateurs can evolve and adapt their menu pricing so that they can continue to pursue growth in today's tight marketplace. The result is a roadmap that provides guidance on how to integrate consumer research into your pricing strategy. In this paper, we show how consumer data can be used to clear a path forward for successful implementation of price increases made necessary by the current economy and rising commodity costs.

Taking a consumer-based approach to pricing helps operators better understand, before price increases are implemented, how consumers may respond. Armed with this knowledge, operators will be better able to find the right pricing mix. Specifically, consumer research on pricing gives restaurant operators the ability to assess whether their price increases match consumers' expectations, and identifies menu items for which price elasticity is greatest. Of course, what people say they will do in surveys and what they actually wind up doing can be different. The recommendations in this white paper should be read as a form of "homework" leading up to real-life market testing. They should be one part of the strategic planning process.

We suggest three consumer-based research essentials:

1. Measure consumer pricing expectations. What are consumers expecting to pay or willing to pay for your menu items?
2. Assess your brand's competitive strength by benchmarking both your current prices and your projected price increases against consumer perceptions of your brand's value. Do your prices hit the mark, aligning well with how consumers view your brand? Do consumers perceive your restaurant as affordable? Will your brand be strong enough to maintain steady levels of customer loyalty if your prices increase?
3. Test price increases with consumers. Which menu items can withstand higher price increases than others?

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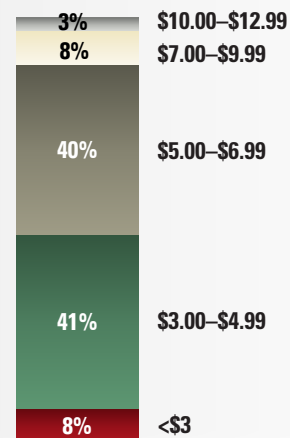
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1. Measure Consumer Pricing Expectations

One of Technomic’s recent surveys indicated that a large majority of consumers are willing to pay up to \$6.99 per person for a meal at a quick-service restaurant (see Exhibit 1). On the surface, this seems fairly straightforward. However, when we look at both restaurant check averages and the prices of value meals at quick-service restaurants, we find that certain chains are approaching or have even overshot the ceiling of what consumers are willing to pay. The good news is that a chain with a strong brand image and strong consumer perception of affordability is better positioned to break through that price ceiling. For this reason, we continue to see growth in chains that meet this criteria even as they raise their prices.

Exhibit 1: Reported Willingness to Pay at Quick Service

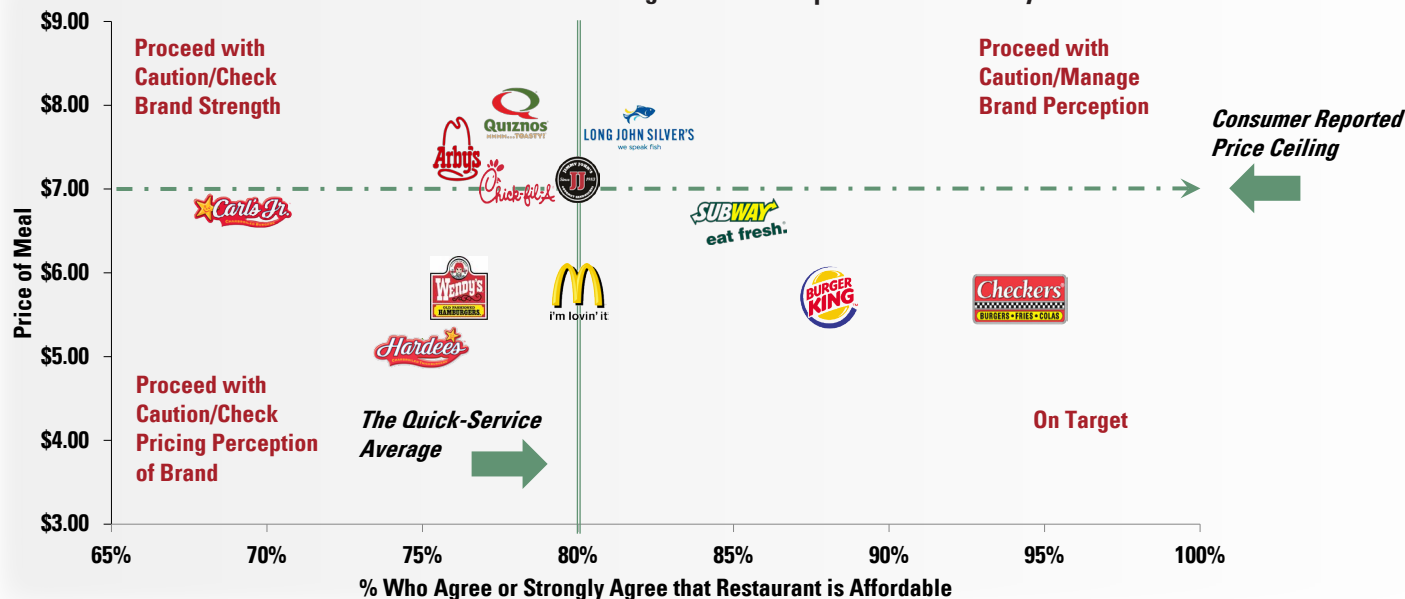


2. Compare Current and Future Pricing to Consumer Expectations

When planning price increases, it is helpful to know how consumers perceive your brand. They place higher economic value on some restaurant chains than others. To illustrate, Exhibit 2 plots the estimated check averages of certain chains against the percentage of consumers who report that the chain is affordable for them and consumers’ reported willingness to pay.

Looking at the chart, we see that some chains are better positioned than others to implement price increases; i.e., these chains are viewed as affordable despite having check averages at or above the ceiling of what consumers say they are willing to pay. Chains such as Subway, Burger King, McDonald’s and Checkers sit in a fairly comfortable zone. They have average or above-average affordability ratings, and their check averages fall well below the consumer reported price ceiling. Chains that do not fall into this zone regarding pricing must rely on the competitive strength of their brand to help them successfully take significant price increases. In such cases, we suggest proceeding with caution.

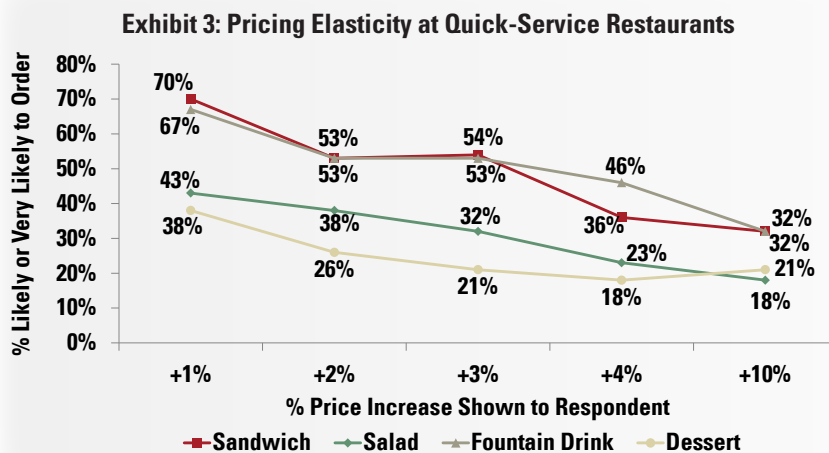
Exhibit 2: Restaurant Pricing and the Perception of Affordability



3. Test Pricing Elasticity

It also helps to test potential price increases on specific menu items. In a recent survey, we tested hypothetical price increases on general food items and found variable price elasticity. The survey randomly assigned respondents to experience either

a 1%, 2%, 3%, 4% or 10% price increase. Exhibit 3 shows that for most menu items, consumers' likelihood of ordering the item drops significantly after a 1% price increase. However, some menu items may be better candidates for a 2% to 3% price increase, because consumers who saw either price increase in the survey report being equally as likely to order these items. Fountain drinks and sandwiches are examples. In other words, if you are not going to experience any more of a purchasing setback at a 3% price increase than you are at 2%, it will be easier to take the larger increase to protect your margin. That would not be true for a menu item for which the price threshold is less elastic.



In short...

The central lesson we learned in our pricing research is that a “one size fits all” approach to price increases will not work. Many factors influence whether consumers will accept price increases. Restaurateurs simply cannot ignore the consumer side of the pricing equation. Consumers’ pricing expectations and their perceptions about a brand’s quality and affordability all play important roles in determining whether they will remain loyal to that brand after a price increase. The optimal strategy is for chains to test specific menu items against consumers’ pricing expectations and perceptions of their brand. The question is how best to do so. Based on this approach, the following steps will help better incorporate consumer data into your pricing strategy.

- STEP 1** → Conduct consumer research to evaluate perceptions of your brand and the value position you offer and test the pricing elasticity of items on your menu. This could involve a comprehensive survey program that assesses your brand’s strength compared to your competitors’ and tests consumers’ reactions to potential price increases. It might also include transactional and in-house customer data.
- STEP 2** → Conduct a market assessment that indexes your menu prices against the prices of your core competitive set.
- STEP 3** → Cross-reference your research results from steps 1 and 2. This will help you pinpoint your position in the market and allow you to define the impact that different price points would have on your growth goals. An example of this was provided in Exhibit 2.
- STEP 4** → Construct strategically targeted pricing tiers that match consumer pricing expectations in different demographic groups (e.g. income) and geographic locations (e.g. suburban, urban, rural, etc.) to your pricing needs as defined by your costs.
- STEP 5** → Test the pricing tiers in strategic locations. If the test goes well (i.e. consumer response is satisfactory), proceed to step 6. However, if the path forward still remains unclear, review or rerun steps 1 through 4 for further insights.
- STEP 6** → Roll out the pricing strategy systemwide.

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